

ILLINOIS POWER COMPANY**ILLINOIS COMMERCE COMMISSION****DOCKET NO. 99-****EXHIBITS SPONSORED BY ALEC G. DREYER****APRIL 16, 1999**

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ILLINOIS COMMERCE COMMISSION**DOCKET 99-_____****PREPARED TESTIMONY OF ALEC G. DREYER****I. Introduction and Witness Qualifications**

21 1. Q. Please state your name, business address and present position.

22 A. My name is Alec G. Dreyer. My business address is 2828 N. Monroe St.,
23 Decatur, Illinois 62526. My present position is Senior Vice President of
24 Illinova Corporation (“Illinova”) and Illinois Power Company (“Illinois
25 Power” or the “Company”), and President of Illinova Generating
26 Company, a wholly-owned subsidiary of Illinova. I am also the President
27 of Illinova Power Marketing, Inc., the newly created subsidiary of Illinova,
28 which is referred to as the wholesale electric service company (“WESCO”).

29 2. Q. Please state your professional qualifications and business experience.

30 A. I am a 1980 Phi Beta Kappa graduate of the University of Illinois with a
31 Bachelor of Arts Degree in political science, pre-law and accounting. In
32 1987, I earned a Masters of Business Administration with distinction from
33 Washington University in St. Louis. I was employed by Price Waterhouse
34 as Senior Manager in the Accounting and Auditing Services division. I
35 joined Illinois Power as Controller in June 1992 and was elected
36 Treasurer in 1994. I am a Certified Public Accountant (“CPA”) in Illinois
37 and Missouri, and licensed to practice as a CPA in Illinois. I am a member
38 of the Illinois Society of Certified Public Accountants and the American
39 Institute of Certified Public Accountants.

40 3. Q. What are your responsibilities in your current position?

41 A. I am responsible for all of Illinova's non-nuclear generating facilities, as
42 well as strategy development, business formation and operating
43 performance for Illinova Generating's principal functions: domestic and
44 international power plant development, investment, and operating and
45 maintenance services.

46 4. Q. Have you previously testified before the Commission?

47 A. Yes, I previously testified before the Commission in Docket Nos. 92-0404,
48 93-0183 and 94-0005.

49 5. Q. In addition to IP Exhibit 1.1, which is your prepared direct testimony, are
50 you sponsoring any other exhibits?

51 A. Yes, in addition to IP Exhibit 1.1, I am also sponsoring IP Exhibits 1.2
52 through 1.5, which were prepared under my supervision and direction.

53 **II. Purpose of Testimony and Scope of Case**

54 6. Q. What is the purpose of your testimony in this proceeding?

55 A. The purpose of my testimony is to provide an overview of Illinois Power's
56 direct case presentation in support of the transfer of its fossil generating
57 assets to Illinova and then to a wholly-owned WESCO. In addition, I will
58 address Illinova's overall corporate strategy in the evolving electric
59 industry and how this transaction fits into that strategy. I will describe the
60 WESCO subsidiary over which I will have responsibility and how that
61 subsidiary will be able to carry out its obligations under the Power

Purchase Agreement (“PPA”) under which Illinois Power will have access to the fossil generation assets.

7. Q. Are other Illinois Power witnesses presenting testimony in this case?

A. Yes, testimony is also being presented by Robert A. Schultz, Illinois Power’s Vice President - Finance, and a panel comprised of Robert D. Reynolds and Richard W. Eimer, Jr., both of whom are Vice Presidents of Illinois Power. Mr. Eimer is also Vice President of WESCO.

Mr. Schultz presents evidence relating to the financial issues associated with the proposal. His testimony will show that there will not be a strong likelihood that Illinois Power will be entitled to request an increase in base rates under Section 16-111(d) of the Public Utilities Act (the “Act”) during the “mandatory transition period” as a result of the transfer. In fact, it is extremely unlikely that, with the asset transfer, Illinois Power would become eligible to request an increase in its base rates during the mandatory transition period. Messrs. Reynolds and Eimer will demonstrate that after the transfer Illinois Power will continue to be able to provide its tariffed services and carry out its service obligations in a safe and reliable manner.

9. Q. Has the Company filed with the Commission a notice of the transfer of the fossil generating assets to Illinova along with the other materials and information required by Section 16-111(g) of the Act?

A. Yes, pursuant to the requirement of Section 16-111(g) of the Act, the Company filed its notice with the Commission on April 16, 1999. It is my

understanding that all of the statutory filing requirements for the transfer of the fossil generating assets have been met.

III. Illinova Corporate Strategy

10. Q. Please describe the asset transfer by Illinois Power to Illinova and the related transactions which will result in the formation of WESCO.

A. Illinois Power will transfer its non-nuclear generating assets to WESCO, a power supply company wholly-owned by Illinova. This will be accomplished as follows. First, the fossil generation assets will be sold by Illinois Power to Illinova. Second, Illinova will make a capital contribution of the fossil generation assets to WESCO. At the outset, WESCO's primary responsibility will be to continue to meet the electric supply needs of Illinois Power's customers. This will be accomplished through the PPA between WESCO and Illinois Power. This PPA will ensure that Illinois Power's electric customers see no reduction in level of service as a result of the transfer. The initial term of the PPA extends through the end of the mandatory transition period, December 31, 2004, with provisions for annual renewal thereafter.

11. Q. What assets will be transferred to WESCO?

A. Illinois Power will transfer assets used in the generation of power at all non-nuclear power stations. These stations include Baldwin, Havana, Hennepin, Vermilion, Wood River, Stallings and Oglesby, as well as Illinois Power's interest in the Tilton combustion turbines currently under construction. The assets being transferred include the general and

108 intangible plant associated with Illinois Power's fossil generation
109 operations; the existing fuel inventory, plant materials and operating
110 supplies at each power station; and Illinois Power's SO₂ emission
111 allowance ("EA") inventory. These assets include not only the property,
112 plant and equipment that constitute the fixed power generating facilities
113 and associated fuel handling and waste disposal facilities, but also the
114 vehicles and other motor-operated equipment, tools, computers, testing
115 equipment, communications equipment, furniture and other personal
116 property used in the production function. A comprehensive listing of the
117 assets being transferred is included in the Company's notice and a summary
118 listing is included in Mr. Schultz's exhibits. After the transfers, WESCO
119 will own the physical assets currently used by Illinois Power in the
120 production of electric energy through non-nuclear generation.

121 12. Q. Why has Illinois Power decided to transfer its non-nuclear generating
122 facilities to an affiliate?

123 A. Several factors led the Company to conclude that it should transfer its
124 non-nuclear generating facilities at this time. First, the electric industry has
125 been restructuring for several years. As a result of actions by the Federal
126 Energy Regulatory Commission ("FERC"), the wholesale power market is
127 now competitive. This has led to many states initiating restructuring at the
128 retail level. In November 1997, the Illinois General Assembly passed the
129 Electric Service Customer Choice and Rate Relief Law of 1997
130 ("Restructuring Law") which provides for an orderly transition to a

131 competitive retail electric market in Illinois. All of these events led to the
132 conclusion that the Company must take the necessary steps to transition to
133 a competitive wholesale generation market. Our concern is that if the
134 necessary transition steps are not taken, Illinois Power and Illinova will be
135 unable to compete in the deregulated market. Establishing WESCO will
136 allow Illinova to position itself in the evolving deregulated generation
137 marketplace, while at the same time maintaining the regulated structure of
138 the delivery business in Illinois Power. The proposal is consistent with the
139 changing electric utility industry and the policy of the State of Illinois as
140 reflected in the Restructuring Law. In short, WESCO provides Illinova a
141 “fresh start” in the competitive energy industry.

142 Moreover, the asset transfer will better enable Illinova and its
143 subsidiaries to focus on their separate lines of business. It will also position
144 WESCO, like the companies with which it will be competing, with the
145 corporate flexibility to act as quickly as its unregulated competitors are
146 able to do.

147 14. Q. Did the status of the Clinton Power Station factor into Illinois Power’s
148 decision to transfer its fossil generating units to an affiliate?

149 A. The Clinton situation is related to the WESCO transaction. The Illinova
150 Board has made clear its intention that Illinois Power exit the nuclear
151 business by either selling or shutting down Clinton. As part of that
152 strategy, the Company applied to the SEC for approval to carry out a
153 quasi-reorganization, which was approved and implemented as of

December 31, 1998. The result of that quasi-reorganization was to change the values of the Company's nuclear and non-nuclear generating assets on the Company's books to their respective market values. This step was based on the expectation that competitively-based fair value will be realized. However, the manner in which the Company will exit the nuclear business may not be decided until the end of 1999. Clearly, we would like to resolve all issues related to our generation assets as soon as possible. The WESCO transaction resolves a portion of those issues.

15. Q. Are there any other factors that affected your decision to implement the fossil generating asset transfer at this time?

A. Customer choice of supplier is coming to Illinois on October 1st of this year. Illinova wants to be in a position to compete for those customers. We believe the transfer is consistent with the manner in which the Illinois General Assembly anticipated restructuring would occur. The Illinois General Assembly provided a mechanism that utilities could use to position their generating assets for a competitive environment by enacting Section 16-111(g).

16. Q. Were alternatives to a transfer to WESCO of Illinois Power's non-nuclear assets considered?

A. Other alternatives, such as the sale of the generating units to an unaffiliated entity, were considered. However, at this stage of the transition to competition, the Company concluded that the WESCO structure, which involves the transfer of generating assets to an affiliated company, is the

177 superior alternative to transition the Company to a competitive market
178 while continuing to meet the supply needs of Illinois Power's tariffed
179 service retail customers.

180 17. Q. Will Illinois Power's retail electric customers observe any difference in
181 their electric service after the proposed transfer?

182 A. No, Illinois Power's electric customers will see no difference in the level or
183 quality of service they receive, nor will the price they pay increase as a
184 result of the transfer to WESCO. The transfer of assets from Illinois
185 Power to WESCO has been structured in a manner that enables Illinois
186 Power to meet its service obligations in the same manner as it does today.
187 We recognize that Illinois Power remains the entity required to meet the
188 service obligations defined within the Act, as described in the Company's
189 notice and in the testimony of Messrs. Reynolds and Eimer. The
190 transaction will be transparent to customers. Illinois Power will remain the
191 customers' regulated electric utility and, as described in detail in the
192 Company's notice and in the testimony of Messrs. Reynolds and Eimer,
193 will maintain all of its statutory service obligations and will continue to
194 provide adequate, safe, and reliable electric service.

195 18. Q. Please describe the financial transactions necessary to transfer the fossil
196 assets to WESCO.

197 A. The transfer will involve several steps, which will occur simultaneously.
198 First, Illinois Power will sell its fossil assets to Illinova in exchange for an
199 interest bearing note. Mr. Schultz describes the terms of the note in his

200 testimony. Second, Illinova will make a capital contribution of the fossil
201 assets to WESCO. Third, the PPA between Illinois Power and WESCO
202 will go into effect. IP Exhibit 1.2 is a diagram depicting these transactions.
203 In addition, as soon as possible after the transfer is implemented, WESCO
204 will refinance a portion of its assets. It is expected that approximately
205 \$800 million of debt will be issued. WESCO will use the proceeds to buy
206 back this amount of its equity from Illinova. Illinova will in turn use those
207 proceeds to pay down approximately \$800 million of the note which it gave
208 to Illinois Power as consideration for the fossil generation assets. Mr.
209 Schultz describes the uses which Illinois Power will make of those
210 proceeds. IP Exhibit 1.3 is a diagram illustrating the refinancing
211 transactions.

212 19. Q. Are any other regulatory approvals required in order to implement this
213 proposal?

214 A. Yes, it will be necessary for the FERC to approve the PPA and the
215 interconnection agreement between WESCO and Illinois Power. In
216 addition, the accounting entries for the asset transfer will be filed with
217 FERC. The Company has also included with its notice filing an interim
218 services and facilities agreement between Illinois Power and WESCO
219 which will be used only until the proposed new Services and Facilities
220 Agreement among and between the Illinova companies, which was filed
221 with the Commission on February 26, 1999, in Docket 99-0114, goes into
222 effect. The interim agreement is explained in more detail below.

223 20. Q. Will WESCO be required to maintain its books in accordance with the
224 FERC's Uniform System of Accounts?

225 A. Yes, WESCO will be required to do so.

226 21. Q. When will the asset transfer be implemented?

227 A. Given the 90-day period for Commission review of this proposal and the
228 time required for FERC review and approval of the PPA, we expect to
229 complete the transfer to WESCO and for WESCO to become fully
230 operational in September 1999. We anticipate filing the PPA with FERC
231 on or about June 15, 1999. However, in no event will these transactions be
232 implemented prior to September 1, 1999.

233 **IV. Organization, Resources and Staffing of WESCO**

234 22. Q. How will WESCO be organized and staffed in order to meet its obligations
235 under the PPA to provide capacity and energy to Illinois Power on a
236 reliable basis?

237 A. WESCO is a wholly owned subsidiary of Illinova. It was incorporated in
238 April, 1999, under the preliminary name Illinova Power Marketing, Inc.
239 We intend to change the name in the near future, although a final name has
240 not yet been selected. Currently, the only employees of WESCO are the
241 officers, which include Mr. Eimer, the Vice President, Leah Manning
242 Stetzner, the Secretary, and me.

243 23. Q. Please describe WESCO's staffing after the transfer.

244 A. All existing employees of Illinois Power's Wholesale Energy Business
245 Group will become employees of WESCO. Specifically, management and

union employees at each of the power stations, support employees at Illinois Power headquarters who are directly involved in fossil generation operations, regional power plant services employees, and employees at our energy center who are involved with wholesale energy transactions, will become employees of WESCO. The associated collective bargaining agreements will be assumed by WESCO as well. After the transfer, WESCO will have employed the necessary support personnel who previously were responsible for: procurement of fuel and other products and services necessary in fossil operations; performance monitoring; fossil station engineering; fossil generation maintenance planning, scheduling and supervision; planning and implementation of fossil generation units capital improvement projects; and wholesale power marketing and trading activities. In total, approximately 550 Illinois Power employees involved in fossil generation operations will become WESCO employees. The current managers of each of the fossil generating stations will remain the managers of those stations under WESCO ownership. As a result, immediately upon the transfer, WESCO will commence operations with the same experienced management team and work force that today operate Illinois Power's fossil units.

24. Q. Will WESCO have to obtain its own fuel supply to commence operations at the time of the transfer?

A. No, all existing fuel inventories will be transferred to WESCO, as will existing fuel supply and transportation contracts. As a result, WESCO will

commence operations with established fuel reserves and fuel supply sources with which to operate the fossil units. As I have mentioned, WESCO will commence operations with its own in-house fuel procurement capabilities.

25. Q. Will WESCO have to obtain its own environmental permits and EAs?

A. No, all permits or licenses needed to operate the fossil units, currently held by Illinois Power, will be transferred to WESCO, as will Illinois Power's existing inventory of SO₂ EAs. This will ensure that WESCO commences operations with the environmental and other permits and licenses necessary to operate the fossil generating units.

26. Q. Will all other contracts necessary to run the fossil generating units be assigned to WESCO?

A. Yes, all other existing contracts for the provision of products and services needed to run the fossil units will be assigned to WESCO. These contracts cover a wide range of products and services ranging from contracts for operating materials and spare parts to contracts for maintenance of plant equipment to contracts for janitorial services and supplies. As a result, WESCO will commence operations with access to the necessary materials, products and services through established contractual arrangements.

27. Q. Will WESCO have the financial capability to meet its commitments in the PPA and to continue to properly operate and maintain the generating units?

A. Yes, it will. IP Exhibit 1.4 contains the projected financial statements for WESCO, including its income statement, balance sheet and statement of cash flows, for the years 2000-2004. As this exhibit shows, the subsidiary

will have (after the refinancing transaction I described earlier) assets of \$2.7 billion, debt of \$800 million, and shareholders' equity of about \$1.9 billion. Its revenues will consist primarily of PPA revenues, but will also include revenues from wholesale energy transactions. WESCO will have strong cash flow, as shown on its statement of cash flows. All cost responsibilities currently borne by Illinois Power's Wholesale Energy Business Group will become the responsibility of WESCO.

28. Q. What will be Illinova's sources of income and cash to pay the periodic interest payments on the note to Illinois Power?

A. Illinova is projected to have substantial net income during the forecast period after payment of the interest due to Illinois Power and on other obligations. With respect to sources of cash, Illinova's projected cash flows from dividends on common stock paid to it by Illinois Power and WESCO, common equity repurchases by WESCO, and income tax savings due to the interest deductions on the note, are projected (without taking into account any other sources of cash to Illinova) to be substantially in excess of the interest payments due on the note in each year of the forecast period.

29. Q. Will WESCO obtain any services from Illinois Power or Illinova?

A. Initially, WESCO plans to obtain administrative, overhead and support services from Illinova or Illinois Power. These services will include, for example, human resources (including payroll and benefits administration), safety and health programs administration, financial planning and

management, cash management and treasury, accounting, insurance and claims, internal auditing, legal services and public affairs, information technology services, and some procurement services (primarily relating to non-fuel operating materials and supplies). In the future, WESCO may develop internal capabilities to provide some or all of these services, or may elect to obtain services from competitive third party providers.

30. Q. Has the Commission approved a services agreement between Illinois Power and WESCO under which such services could be provided?

A. Illinois Power and Illinova have a Services and Facilities Agreement in place which was approved by the Commission in Docket 94-0005. While we believe this agreement could be utilized for the provision of services by Illinois Power to WESCO, it does not provide for the provision of services from WESCO to Illinois Power, which will be necessary once the transfer takes place. On February 26, 1999, Illinois Power requested approval of a new Services and Facilities Agreement between and among Illinova, Illinois Power and all other Illinova subsidiaries. Unlike the current agreement, the new agreement is reciprocal since it provides for services and facilities to be provided both by Illinois Power and to Illinois Power. When the new Services and Facilities Agreement is ultimately approved by the Commission, it will become the basis for the provision of services and facilities by and among Illinova, Illinois Power and any other subsidiary of Illinova.

337 31. Q. What if the new Services and Facilities Agreement is not approved prior to
338 the transfer of assets to WESCO?

339 A. In the event that the new Services and Facilities Agreement is not approved
340 prior to the transfer of assets to WESCO, Illinois Power has included in its
341 notice filing an Interim Services and Facilities Agreement, to be applicable
342 solely to transactions between Illinois Power and WESCO. IP Exhibit 1.5
343 is a copy of the Interim Agreement. This Interim Agreement incorporates
344 all of the terms and conditions of the proposed agreement pending in
345 Docket 99-0114 and would be effective as to any services and facilities
346 provided by Illinois Power to WESCO, or vice versa. The Interim
347 Agreement will terminate and be superceded by the new agreement when
348 the new agreement is approved.

349 32. Q. Will Illinois Power and WESCO comply with all applicable requirements
350 and restrictions on transactions between affiliates?

351 A. Yes, Illinois Power and WESCO will comply with all such restrictions.

352 33. Q. What is the PPA and how does it impact WESCO and Illinois Power?

353 A. The PPA is an agreement between WESCO and Illinois Power under which
354 WESCO is obligated to make capacity and energy available to Illinois
355 Power. The PPA is subject to FERC approval and states the terms under
356 which WESCO will provide electricity to Illinois Power to serve Illinois
357 Power's load. The PPA provides assurance that Illinois Power will
358 continue to be able to provide adequate and reliable generation service to

its tariffed service retail customers. Messrs. Reynolds and Eimer describe the relevant provisions of the PPA in detail.

34. Q. Won't Illinois Power's customers be adversely affected by the transfer of Illinois Power's generating assets, given the events of last summer?

A. No, generation services reliability for Illinois Power retail customers will not be affected by the transfer of Illinois Power's fossil generation assets to WESCO. Messrs. Reynolds and Eimer provide the analyses supporting this conclusion, which were also provided in the Company's notice.

35. Q. Please describe the security guarantee which WESCO must provide under the PPA.

A. Under the PPA, WESCO must post a security guarantee in favor of Illinois Power in the amount of \$25,000,000 to ensure the timely performance of WESCO's obligations to deliver capacity and energy to Illinois Power, including any obligations of WESCO under the PPA to pay money to Illinois Power. WESCO's security guarantee may be provided through a corporate guarantee by Illinova, unless the credit ratings of Illinova's senior debt by Moody's and Standard & Poor's fall below investment grade, in which case WESCO must within 15 days provide the security guarantee in the form of an irrevocable letter of credit, guaranty or bond issued by a bank, insurance company, other financial institution or other guarantor, of acceptable creditworthiness to Illinois Power, in favor of the Company. The security guarantee will be available as a source of reimbursement to Illinois Power if, for example, WESCO fails to deliver the required amount

of energy for a period of time and Illinois Power were required to obtain replacement energy on the market at higher prices than provided under the PPA.

36. Q. Please summarize your testimony.

A. Illinova and Illinois Power must transition themselves in the face of restructuring and the changing marketplace. Transferring Illinois Power's non-nuclear generation to an affiliate is a transaction specifically contemplated by Section 16-111(g) of the Restructuring Law and is consistent with the objective to participate in competition. The PPA between Illinois Power and WESCO will ensure that Illinois Power will continue to meet its obligation to provide adequate and reliable service to its tariffed service retail customers. Illinois Power's retail electric customers' base rates are frozen through the mandatory transition period ending December 31, 2004, and there is not a strong likelihood that the transfer would result in the Company being entitled to request a base rate increase under Section 16-111(d). Further, Illinois Power has eliminated its fuel adjustment clause. Therefore, Illinois Power's tariffed service retail customers are insulated from any price risk related to the transfer. Thus, the Commission should conclude that the transfer meets the standards of Section 16-111(g) of the Restructuring Law.

37. Q. Does this conclude your direct testimony?

A. Yes, it does.